Neoliberalism, The Asian Financial Crisis, and Structural Adjustment Programs: The Case of Thailand

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ABSTRACT

As is the case with several other developing countries which grew rapidly in the 1980s and 1990s, Thailand was largely influenced by neoliberalism. This essay discusses neoliberalism, its influence on Thailand, and the role that neoliberalism played in the subsequent Asian financial crisis. Thailand's swift economic rise through the mid-1990s, was followed by a severe economic and financial crisis that would spread to other countries in the region. Once the Asian financial crisis had commenced, the IMF intervened and introduced a set of policies which yielded some unintended consequences.

Keywords: Neoliberalism, economic growth, international development, financial markets, Asian financial crisis, institutions, Thailand

JEL Classification: E44, F33, F63, O19, O23, O24, O43

INTRODUCTION

In 1980, nearly 70 percent of Thailand's labor force was employed in the agricultural sector (Leturque and Wiggins, 2010). Over the 16 years that followed, Thailand would come to experience a rapid transition from an agricultural-based economy, to one that became increasingly industrialized and export-dependent. As is the case with several other developing countries which grew rapidly in the 1980s and 1990s, Thailand was largely influenced by neoliberalism. This essay discusses neoliberalism, its influence on Thailand, and the role that it played in the subsequent

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NEOLIBERALISM

Neoliberalism is a theory that over time has become associated with economic liberalization policies that include: deregulation, privatization, free trade, austerity, and reductions in government involvement – all aimed at increasing the role of the private sector in the economy and society. David Harvey defines neoliberalism as: "a theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms, free markets, and free trade." (Harvey, 2005). Thus, free market efficiency is prioritized.

Neoliberal rhetoric explains that individual freedoms can only be advanced and guaranteed by allowing prices to be determined by unrestricted competition between privately owned businesses. Greater liberty and personal freedom have become pillars of neoliberalist theory. Consequently, neoliberalism proposes a *laissez faire* approach which can only function as long as there is limited government oversight and regulation.

Neoliberalism has been advocated by some and criticized by others. Led by Milton Friedman, a group of economists known as the 'Chicago Boys' began to support the idea that a state could be reformed and transformed by developing an economic and political economy structure that would allow private interests to take over. And thus, Chile became the first experiment of neoliberal state formation. Meanwhile, the Mont Pelerin Society, whose members were powerful and wealthy corporate leaders, sponsored neoliberal theory and began to influence

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the discourse surrounding country development and economic growth. Following the neoliberalist doctrine, Chile reduced its trade barriers, privatized, and deregulated. A few years after the Chilean experiment, Keynesian interventionists and others who were in favor of a state planning approach, began to criticize the ills that stemmed from applied neoliberalist policies. They cited that radical economic reform led to income inequality, lower wages, and poor working conditions. Critics of neoliberalism such as Dani Rodrik have argued that neoliberalism exacerbates poverty and inequality (Rodrik, 2002). Neoliberalism has been criticized for focusing on economic efficiency, while it has severely affected the working class and the economically disadvantaged.

THAILAND AND NEOLIBERALISM

Following a path to growth that other developing countries also embraced, Thailand switched from import substitution industrialization (ISI) to export-oriented industrialization (EOI). Starting in the early 1980s, multinationals and financial institutions heavily promoted free trade and proposed deregulation as a means to helping Thailand grow economically. During the 1980s and early 1990s, multinational corporations and financial institutions became prominent 'agents of neoliberal change' while the Thai government took steps to deregulate. Capital controls were changed to allow greater freedom of funds to flow to and from the Thai economy.

International bankers seeing the tremendous potential for economic expansion and for increasing trade flows made credit available to Thai firms. Commercial banks around the world flooded Thailand with loans which were used to finance investments, including real estate ventures and infrastructure projects. Because Thailand had high domestic interest rates, Thai borrowers found it cheaper to borrow funds from foreign banks. Thai firms borrowed heavily intending to turn these funds into tools for leveraging their growth.

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Following the advice of international economic advisors, Thailand had a fixed exchange rate policy, and its currency, the baht, was pegged to the US$. High interest rates combined with a pegged currency attracted foreign investors to Thailand, as many investors perceived no currency risk. In 1992, as part of a financial liberalization package, Thailand deregulated foreign exchange and made it possible for local and foreign banks to take deposits or borrow in foreign currencies abroad, and lend funds both in Thailand and abroad.

Eventually, Thailand would experience what some have called 'private sector failure' due to careless lending and borrowing, and the accumulation of nonperforming loans in the financial sector (Lauridsen, 1998). Some argue that Thailand's financial liberalization took place in an uncontrolled financial sector which then resulted in resource misallocation and poor investments. Institutions whose liabilities were perceived as having an implicit government guarantee were essentially unregulated and therefore subject to severe moral hazard problems (Krugman,1998). Companies effectively carried too much debt on their balance sheets which they were not able to repay, and had inappropriate debt maturity structures (Deesomsak et al, 2009). Also, excessive risky lending created inflation of asset prices which eventually contributed to Thailand's financial market collapse and to the onset of the Asian financial crisis.

ASIAN FINANCIAL CRISIS 1997-1998

With the collapse of its financial market, along with a high burden of foreign debt, Thailand was effectively bankrupt. Because financial markets had become increasingly integrated in a globalized environment, financial contagion spread to other countries. Most of Southeast Asia and Japan saw slumping currencies, devalued stock markets and other asset prices, as well as a sharp increase in private debt. Moreover, affected countries' foreign debt-to-GDP ratios heightened.

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Scholars have sought to investigate the causes for Thailand's financial market collapse and for the emergence of the Asian financial crisis. Studies have cited laxed supervision, weak regulation, a rapid process of capital account liberalization, excessive credit growth, hot money, and financial market deregulation as factors that lead to the financial collapse and crisis (Charumilind et al, 2006; Corsetti et al, 1999; Goldstein, 1998; Radelet and Sachs, 1998).

Another factor which several scholars have studied is the devaluation of the Thai baht and its repercussions (King, 2001; Wong et al, 2001). Starting in early 1997, the baht faced attacks as currency speculators believed that the currency may have been overvalued. Investors, domestic and foreign, began selling baht for dollars in order to hedge against a possible devaluation. As a consequence, there was a huge supply of baht in the money market. The massive selling of the baht led to the sudden depreciation of the currency. Investors also withdrew capital from Thailand. And foreign loans that had been made to Thai firms suddenly became much more expensive relative to the baht.

Some scholars argue that neoliberalism is responsible for Thailand's financial market collapse and for the ensuing financial contagion (Grabel, 2000; Nesvetailova, 2006; Wolfson, 2000). More specifically, policies and strategies of neoliberalism are claimed to have resulted in aggressive foreign financing of deregulated domestic speculative markets, overcapacity in export markets, capital outflows leading to collapsing currencies, and restrictive macroeconomic policy oriented toward boosting international capital flows which eventually left Asian economies exposed to capital flight.

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THE IMF AND ITS RESPONSE TO THE FINANCIAL CRISIS

In the wake of the Asian financial crisis, the International Monetary Fund (IMF) produced bailout 'rescue packages'. These bailouts were designed to help affected countries avoid default. The IMF required that countries engage in currency, banking, and financial system reforms. As such, the IMF provided financial assistance conditional on "structural adjustment packages" (SAPs) which asked countries to reduce government spending and deficits, allow insolvent financial institutions to fail, and raise interest rates. The IMF argued that following these reforms would help improve fiscal solvency, penalize underperforming insolvent companies, and protect domestic currency values.

The IMF also asked countries to develop adequate government controls to supervise all financial activities. However, many of these countries did not have the necessary resources and institutions to establish effective controls. Moreover, the IMF instructed countries to establish 'transparent' financial systems. Interestingly, the IMF failed to acknowledge that neoliberal policies had played an important role in the convergence of factors such as hot money, currency speculation, and eventual capital flight. The financial crisis was not particularly a consequence of obscure financial dealings, but rather of private sector failure which was fueled by deregulated financial capital markets. In spite of the severe economic and social consequences left behind by the Asian financial crisis, Stanley Fischer, First Deputy Managing Director of the IMF, explained that the role of the IMF is to facilitate the expansion of international trade by encouraging trade liberalization and needed reforms (Fischer, 1998).

In the aftermath of the crisis, the IMF and its SAPs became widely criticized. McGurn argues: "The IMF is perceived within Asia as an institution of Western capitalism prescribing Western capitalist medicine" (McGurn, 2000). The effects of the policies introduced by the IMF

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have been reviewed extensively. For instance, Visser and ter Wengel explain that the priority given by the Fund to monetary and fiscal tightness in Thailand was mistaken as it aggravated the economic downturn and made unemployment even higher. Also, the baht continued to devalue even though the IMF's policies were introduced (Visser and ter Wengel, 1999). Because Thailand's economic problems stemmed from heavy private sector borrowing, and not from public sector spending, some experts believe that the IMF's policy mix of high interest rates and a tight fiscal policy caused more problems than it solved (Bungarten, 1999). The IMF's policies and austerity measures resulted in companies becoming increasingly insolvent, thereby causing higher unemployment, higher poverty levels, lower production, and lower aggregate demand. The middle class and the poor were left worse off.

In Thailand, the exchange rate continued to show even greater devaluation after the IMF introduced its set of policies. Figure 1 below shows the exchange rate of the Thai baht, before and after the 1997 Asian financial crisis. Figure 2 below shows the number of unemployed in Thailand before and after the crisis. Figure 1 suggests that the Fund's policies were not effective in treating currency devaluation, while Figure 2 hints that the IMF's policies may in fact have driven unemployment to increase.

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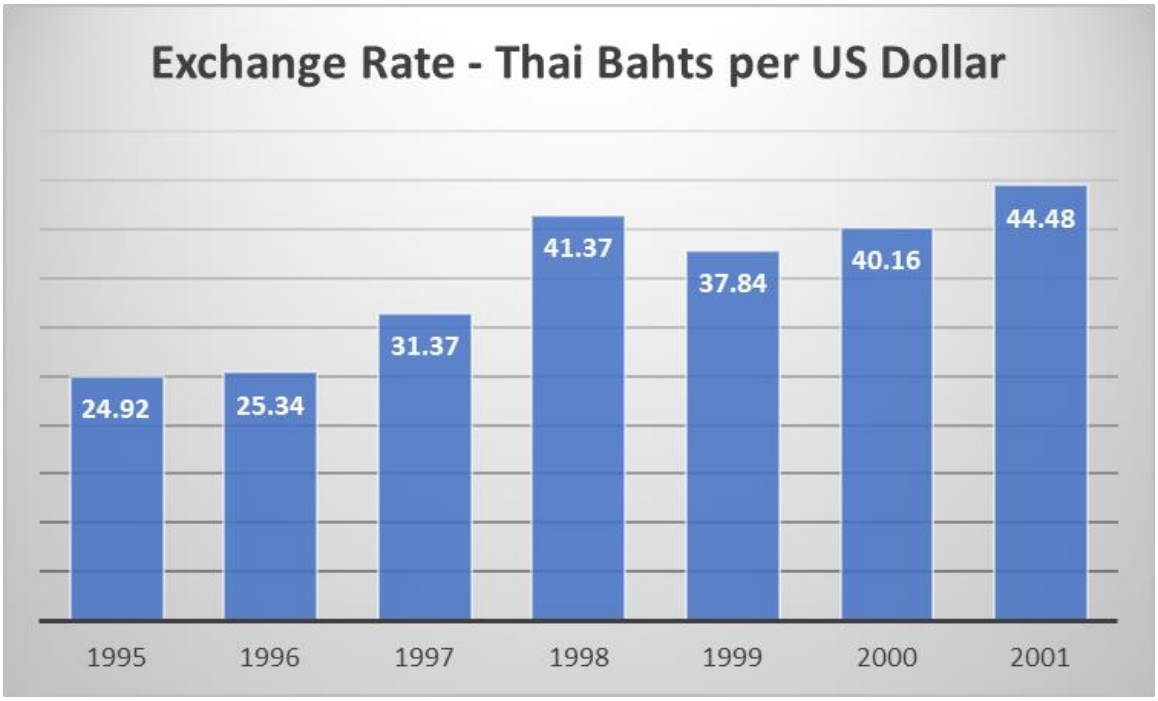
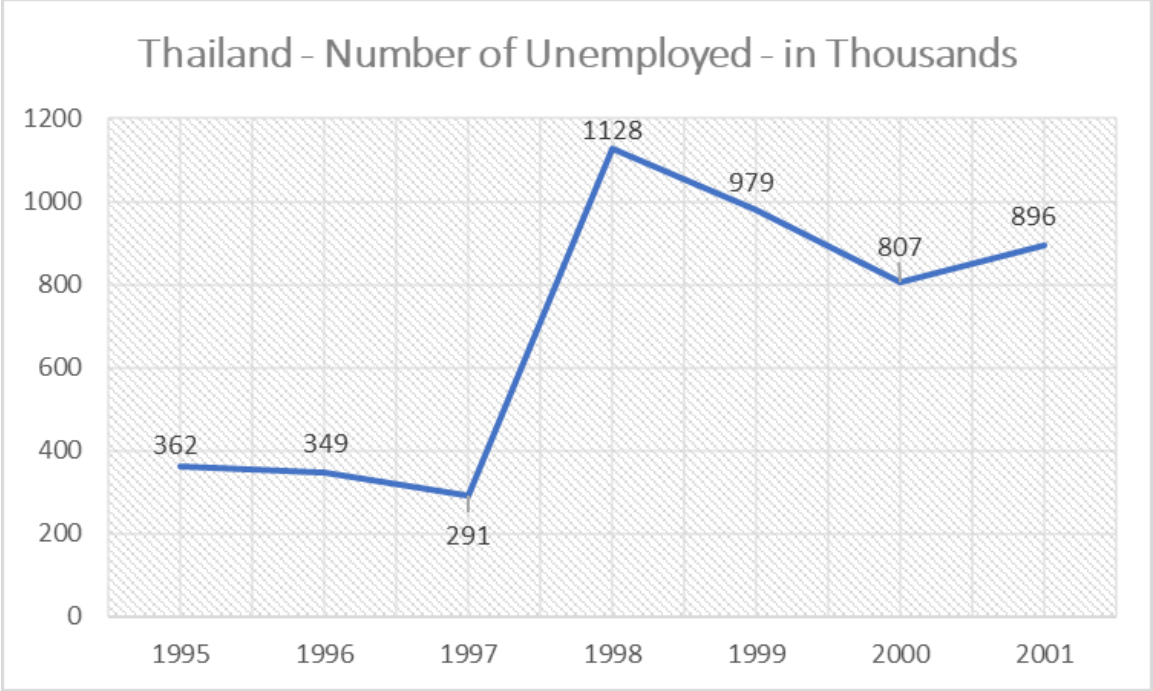
Figure 1: Exchange rate of Thai baht, before and after the 1997 Asian Financial crisis



Source: Author's calculation using data from Bank of Thailand

Figure 2: Number of unemployed in Thailand – before and after 1997 crisis



Source: Author's calculation using data from International Labour Organization – Labour Force Survey

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CONCLUSION

Thailand's economic rise during the 1980s was largely influenced by neoliberalist policies which were promoted by large multinationals and global financial institutions. Ironically, the same deregulation, financial liberalization, and trade liberalization which helped Thailand and other countries grow rapidly, also inadvertently led to private sector failure. The ensuing Asian Financial crisis halted economic growth in several affected countries and resulted in IMF-imposed austerity measures. The IMF's strategies and policies generated externalities which have caused some to question whether their remedy was worse than the illness they tried to cure.

In retrospect, neoliberal policies helped Thailand expand its economy swiftly, yet they also exposed the country to eventual financial distress and market failure. This suggests that neoliberal theory must be applied with caution. If neoliberal policies are to work effectively, strong institutions must be present, along with proper incentives, appropriate financial system structures, and effective regulatory controls and governance mechanisms. Economic globalization has undoubtedly facilitated economic growth and expanded trade flows which have benefited many industries and firms around the globe. Nonetheless, policy makers must be cognizant that some level of governance, oversight, and supervision is needed so as to ensure that the system works effectively, and not just efficiently. Institutions, property rights, and contract enforcement are also critical to ensuring that the 'benefits' of neoliberalism and economic globalization are more equitable and less perverse.

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